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SUBJECT: Toronto's High-Rise Condominium Market:
Cooling, But Not Yet a Meltdown

¶1. (U) Summary: Toronto's market for high-rise condominiums has begun to cool down in what was North America's busiest condo construction and sales market in 2007. The global credit crunch and slowing economy has created worries for Toronto developers with projects currently underway, and even more so for developers with new project proposals still in need of financing. Market analysts believe, however, that factors unique to Toronto such as a steady population influx, relatively rigid lending practices prior to the credit crunch, and favorable local government policies will help developers survive the economic downturn. End Summary.

Building Frenzy Beginning to Slow Down

¶2. (U) For the past three years, Toronto has experienced a condominium building frenzy. In 2005 and 2006 a total of 220 condo projects were launched, while in 2007 alone the total leaped to a record-breaking 295 projects. Despite the slowing real estate market, in the first three quarters of 2008, another 290 condominium projects were launched. [Note: These include condo projects that started sales and/or began construction.] Of the over 38,000 condominium units under construction in Ontario during this same time period, 33,919 were in the Toronto area.

¶3. (U) The market is now showing signs of a slowdown, however. The value of building permits requested in Toronto in September 2008 fell 34% below that of a year earlier, clearly signaling a slowdown in new construction planned for 2009. Moreover, amid global economic uncertainty condo buyers are more cautious about purchasing at the pre-construction stage or are putting off real estate purchases all together.

Downturn May Be Moderate

¶4. (U) Although both developers and analysts here agree that the market will see a downturn, they also believe that it will be moderate. Toronto does not exhibit the negative indicators present in the real estate market meltdowns seen in Vancouver or Miami, Florida. Toronto has only a 2.5-month inventory, for example, compared to Miami's 75-month inventory in February 2008. Toronto pre-construction buyers also have yet to abandon their deposits. Additionally, while Canadian cities like Calgary and Vancouver had overheated housing markets caused by local booms, housing prices in Toronto did not increase as dramatically.

15. (U) Because Canadian banks typically require that a project be 60-70% pre-sold before a developer can qualify for financing, this leaves a less of a burden for builders to find buyers after construction. Toronto's demographic trends will also continue to drive demand for high rise housing. Nearly half of Canada's 225,000 annual immigrants settle in Toronto. Greater Toronto's population is expected to grow from about 5.5 million to 6.9 million people by 2016. Because of this, analysts expect that high-rise sales will continue to account for more than half of all new home sales, leading to expectations that the market's drop in Toronto will be less dramatic.

Local Government Policies to Push Construction Vertically

16. (U) With an estimated population growth of some 28% over the next 24 years, the Ontario government has moved to protect some areas from construction and development. In 2005, it created an 800,000-hectare "Greenbelt" area around Lake Ontario to protect the forests, wetlands, and farmland surrounding southern Ontario. The result has been a concentration of development around established cities, as well as an increase in vertical construction.

17. (U) The Toronto municipal government also has taken action to encourage development within the city. In December 2008, the City of Toronto will review a proposal to freeze the implementation of development charge increases for one year, given the current economic climate. The charges normally levied on developers go towards services and infrastructure (sewers, water mains, government facilities, etc.). City leaders have estimated that 87% of new infrastructure costs incurred through new development will be subsidized by the city, creating a significant incentive for the developers. For 2008, new infrastructure will cost some C\$308 million.

18. (U) Comment: While high-rise projects currently under construction appear to be relatively safe from global economic uncertainty, future developments remain vulnerable to financing difficulties. The credit crisis has Canadian banks more cautious in their lending, and large condominium projects tie up more money for extended periods of time owing to the practice of maintaining mortgages within the bank. [Note: According to a new report from RBC Capital Markets, Royal Bank of Canada and Bank of Nova Scotia had the largest share of residential mortgages among the six largest Canadian banks, based on balance sheets at the end of the April. RBC had a 26.7% market share and Scotiabank had 22.9%.]

19. (U) Developers may have to turn to alternative mortgage options such as mezzanine financing, which blends elements of debt and equity financing, but tends to be more expensive than secured-debt financing (i.e., a mortgage loan). According to a contact at a market research firm, developers have already encountered more stringent equity and presale requirements, as well as higher costs of borrowing and increased bank fees.

At the same time, some industry analysts point out that one possible positive outcome of the economic slowdown may be lower prices for construction materials caused by the recent drop in commodity prices. Overall, analysts foresee a short-term market correction that will bring prices back to pre-2007 boom levels, which were still attractive enough for developers to embark on their building spree. Although, analysts are reluctant to make long-term predictions on the condo market, as of yet there is no perceived sense of panic among developers and buyers. End Comment.

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